Doing More with Less – Fund Financial and Tax Reporting

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Investors increasingly turn to mutual funds to save for retirement and other financial goals. Mutual funds offer advantages of diversification and professional management, but they also come with fees and taxes, which can be cumbersome to manage and can weaken a fund's returns and Net Asset Values (NAVs).

U.S. mutual fund companies are required to price their funds using U.S. GAAP accounting, as well as produce a second set of accounting books (secondary basis) based upon U.S. tax accounting regulations and treatments. Actively managing fund fees and taxes has historically been viewed as front-office and fund board functions.

However, the cost and management of these variables can be controlled with the implementation of investment accounting systems that were designed to support automation for tax and financial reporting. Automating these functions in an investment accounting system assumes transactions are entered once and processed in real time across multiple accounting bases (i.e. GAAP, tax, IFRS), with accounting treatments varying per accounting basis. This also assumes automation for "as of" transactions and out of order processed transactions. Since trades are processed on trade date plus one for U.S. 40 Act funds, each tax and financial reporting period will have "as of" transactions over a month end, quarter end, semi-annual or annual reporting cycle. At these crucial period ends, fund reporting needs to be based on the actual positions held in the fund.

Fund companies and fund service providers struggle to industrialize tax processing and period end reporting, and may have separate systems, sub systems, numerous spreadsheets and distinct operational teams handling these functions. In many cases data is moved from the fund accounting system, to the tax system, to the financial reporting system, which creates many potential areas for errors.

These multiple systems are likely saddled with manual intervention for both tax treatments and "as of" accounting for transactions with conflicting processing and trade dates.

Data is not real time in this operating model, and therefore fund investment decisions are made without the benefit of using the most current fund information. This presents increased risk for both reporting and processing errors. Moreover, it is very costly to maintain the same data set in multiple systems, which makes providing proper reconciliation more difficult and requires higher staffing levels.

This can be remedied through implementing an investment accounting system that has been architected for multi-basis processing along with sophisticated "as of" processing. Such systems offer increased operational efficiency. When a fund is set up, primary, secondary and tertiary accounting bases are assigned and rules are defined with basis-specific elections. One set of transactions is processed across all accounting bases with the specified accounting treatment for each. Also distinct sub and general ledgers are updated across each accounting basis.

Systems that are multi-basis allow for same lot selection, which ensures the same lot is selected across all bases, regardless of the controlling basis. Tax lots should be selected with a user defined weighting to apply to each different kind of gain or loss: short-term gain, short-term loss, long-term gain, long-term loss, currency gain, and currency loss.

When relieving tax lots, the system should accommodate for the effects of wash sales or qualified dividend income, as these are undesirable scenarios from a tax perspective. It would be nearly impossible to incorporate the effects of wash sales in real time into a fund's lot selection methodology, unless the system selecting lots is mindful of wash sales.

Doing more with less and reducing operational risk in the financial services industry continues to be more and more commonplace when examining systems to manage the processing and reporting of mutual funds. Investment firms continue to search for systems that can accommodate numerous functions in the most efficient manner, without losing the sophistication necessary to operate in today's complex and global fund landscape. Industry trends are showing that systems capable of offering multiple solutions with the sophistication necessary to operate in today's market will continue to be the accounting systems of choice for investment managers in years to come.

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